IADC Committee Newsletter

PROFESSIONAL LIABILITY

April 2014

IN THIS ISSUE

This newsletter reviews recent selected non-medical, non-legal professional liability cases.

Recent Professional Liability Cases

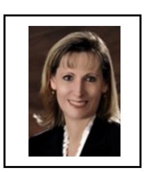
ABOUT THE AUTHOR

Richard L. Neumeier is a partner in the law firm of Morrison Mahoney LLP, headquartered in Boston, Massachusetts. He is the co-author of Chapter 25, Errors and Omissions Insurance in the leading treatise on insurance coverage in the United States, *Appleman on Insurance Law* (Library ed. 2012). He is a member of the American Law Institute ("ALI") and an Advisor to the ALI's Principles of Liability Insurance Project since 2010. He is an active member of the IADC and has been the Editor of the *Defense Counsel Journal* since 1992. He can be reached at rneumeier@morrisonmahoney.com.

ABOUT THE COMMITTEE

The Professional Liability Committee consists of lawyers who represent professionals in matters arising from their provision of professional services to their clients. Such professionals include, but are not limited to, lawyers, accountants, corporate directors and officers, insurance brokers and agents, real estate brokers and agents and appraisers. The Committee serves to: (1) update its members on the latest developments in the law and in the insurance industry; (2) publish newsletters and Journal articles regarding professional liability matters; and (3) present educational seminars to the IADC membership at large, the Committee membership, and the insurance industry.

Learn more about the Committee at www.iadclaw.org. To contribute a newsletter article, contact



Mary G. Pryor
Vice Chair of Newsletters
Cavanagh Law Firm
602-322-4035
mpryor@cavanaghlaw.com

I. Insurance Brokers and Agents

Dr. Stephen Lehman (Dr. Lehman), a licensed prosthodontist, opened his Carmel office of Indiana Restorative Dentistry, P.C. (IRD) in 1978. His spouse, Maureen, is the office manager and handled IRD's insurance. Dr. Lehman was referred to Laven Insurance Agency, Inc. (Laven) to secure the Indiana Dental Association endorsed insurance coverage for a small business. IRD purchased from Proassurance Indemnity Co., Inc. (Proassurance) coverage recommended by Laven. The relationship between Laven and Proassurance is governed by an agency agreement. Laven would annually mail IRD a questionnaire with an existing declarations page and sought to determine any changes in IRD's practice which might effect its insurance. Maureen would complete the questionnaire and return it to Laven. On October 8, 2008 Maureen returned the 2008 questionnaire requesting an increase in contents coverage to $350,000. On October 25, 2009 a fire destroyed the Carmel Office, including office contents, worth $704,394.34. After Proassurance paid the $204,371 policy limits for the loss, IRD claimed that it was underinsured due to Laven's failure to provide advice and to secure additional insurance coverage. Vacating summary judgment for Laven, the court noted that in the absence of a special relationship between the insurance agent and insured, an agent does not have a duty to inform an insured about the adequacy of coverage. Factors demonstrating the existence of a special relationship include (1) exercising broad discretion and servicing the insured's needs, (2) counsel concerning specialized insurance coverage, (3) holding oneself out as a highly skilled insurance expert, or (4) receiving compensation for expert advice provided above the customary premium paid. A mere long term relationship is insufficient, however, in this case Laven "would issue risk review newsletters presenting itself as a highly skilled insurance expert." Restorative Dentistry v. Laven Ins. Agency, 999 N.E. 2d 922, 930 (Ind. App. 2013). There was also a genuine issue of material fact as to whether Laven acted as Proassurance's agent which required that judgment for Proassurance be vacated. Id. at 937.

Cleveland Indians Baseball v. New Hampshire Ins., 727 F. 3d 633 (6th Cir. 2013 – applying Mich. law) involved an accident at "Kid's Fun Day" before a Cleveland Indians ball game on June 12, 2010. Douglas Johnson and David Brown were attending the game as spectators. While looking at an exhibit outside the Kid's Zone, a large inflatable slide collapsed on them. Johnson died nine days later. Johnson's estate and Brown brought a punitive and compensatory damage claim in Ohio state court. National Past Time Sports (National) contracted with The Cleveland Indians Baseball Company to produce "Kid's Fun Day" events before several Cleveland Indian games during the summer of 2010. As part of the entertainment, National agreed to provide the inflatable slide that collapsed. The agreement required National to purchase a comprehensive general liability policy naming the Cleveland Indians as an additional insured. National engaged an insurance broker, CSI Insurance Group (CSI), to procure the required policy. On the first page of the Application sent to CSI, under the heading "Qualification Questions", the box was checked to indicate that the events will have "bounce houses or inflatables." 727 F. 3d at 635. CSI subsequently provided National with a proposal for a policy from New Hampshire Insurance Company, which was accepted. A "Certificate of Liability

Insurance" naming the insured as "National Past Time Sports, LLC" and the "Certificate Holder" as "Cleveland Indians Baseball Company LP" issued on April 27, 2010. Neither National nor the Cleveland Indians received a copy of a full policy before the accident. Shortly after the accident, National contacted CSI and then that learned that, despite its specific request, CSI had mistakenly failed to procure a comprehensive liability policy that covered inflatables. To the contrary there was an exclusion in the policy for "amusement devices" which included "any device or equipment a person rides for enjoyment, including but not limited to, any mechanical or non-mechanical ride, slide, ..." and thus no coverage under the New Hampshire policy. Id. at 636. The Court of Appeals rejected CSI's argument that it owed no duty to the Cleveland Indians because its client was only National. Michigan cases permit liability against other professionals "where the harm was foreseeable and where the defendant has specific knowledge that its actions might harm a specific third party". Id. at 639. The court followed case law in other jurisdictions which held "the economic loss doctrine does not generally bar claims for economic loss as suffered when an insurance broker negligently procures insurance. . . ." (numerous citations omitted). Id. at 640. The court vacated summary judgment for CSI because it was supposed to procure insurance coverage for the slide and it was reasonably foreseeable that CSI was well aware that the additional insured would be harmed if it failed to obtain the intended coverage.

Randy Kersch received an employment proposal from Salto Systems, Inc. (Salto), which outlined a compensation package including a fringe benefit plan, stating "Life Insurance is optional. Not covered by Salto." Kersch v. Unitedhealthcare Ins. Co., 946 F. Supp. 3d 621, 625 (W.D. Tex. 2013). Kersch accepted, started work on July 18, 2011, and that day began working with Linda Leimbach, Salto's Director of Human Resources, on various health benefit issues. Paychex, Inc. is a payroll and human resources company that manages Salto's employee benefits and is also a broker for United Healthcare (UHC). Dennis Walker was Salto's contact at Paychex and answered Kersch's questions about benefits as they were relayed through Leimbach. After the health benefits questions were resolved, Kersch inquired about life insurance through Paychex. By email dated August 1, 2011, Leimbach requested "information on life insurance cost." On August 2, 2011 Kersch received an email from Leimbach stating:

> Hi Randy,
>
> The life insurance offered by Salto via Paychex cost $4.95 per month for $15,000 payout, [sic]. If you are interested let me know.
>
> The completed health insurance enrollment should be faxed to (585-249-4029).
>
> Let me know if you need anything else.

Id. A few days later, Leimbach emailed Walker stating "Is there a special form for signing up for the life insurance and to confirm, is it $4.95 per 15K per pay period?" Walker responded, "The $4.95 premium is per month." Id. at 626. Believing that he could purchase life insurance increments at a rate of $4.95 per $15,000 Kersch calculated that he could obtain $750,000 in coverage for $247.50 per month. On August 18, 2011 Kersch and his wife jointly completed an employee enrollment form on UHC letterhead. Kersch checked the box indicating they wanted Basic Life Insurance and hand-wrote $750,000 in the line where to indicate the dollar amount. Apparently by accident, Kersch did not list his wife's social security number. At 10:21 a.m. on August 22, Walker e-mailed Leimbach saying that Kersch "is all set, just need that social to get his spouse enrolled." Id. At 10:43 a.m. Leimbach forwarded Walker's e-mail to Kersch instructing him to please forward his wife's social to Walker. At some time that day Kersch passed away. When his wife made a claim for life insurance benefits, she received notice that the benefit was limited to $15,000. Suit was filed and the defendants moved to dismiss. The ERISA preemption defense precluded claims against UHC but not Paychex or Walker. The negligent misrepresentation claim need not be pleaded with particularity. A claim was stated against Paychex because

> Plaintiff has alleged that Walker told Mr. Kersch, through Leimbach, to fax his enrollment form to Paychex. . . . Plaintiff has alleged that Mr. Kersch faxed his enrollment form to Paychex on August 11, 2011, and that the form indicated that he was requesting $750,000 in life insurance. . . And plaintiff has alleged that on August 22, 2011, Walker e-mailed Leimbach to say that Mr. Kersch was "all set" and that Walker "just need [ed] that social [Kersch's] spouse enrolled.

Id. at 637. These allegations were sufficient for a negligence claim in failing to procure the insurance. In addition, the complaint stated claims under the Texas Insurance Code and Deceptive Trade Practices Act but the claim for intentional infliction of emotional distress was dismissed. Id. at 642-45.

II. Real Estate

Donald C. Hedstrom decided to purchase two condominium units in Chicago's Lake Point Tower. He reached out to his former wife, Cherie Kotter, a real estate agent, and Hope Geldes, a real estate attorney, to assist him. Hedstrom had married Kotter in 1998 but was divorced about two years later. Nonetheless they remained on good terms and Hedstrom referred to Kotter as his "good friend and companion" in his will and living trust. On August 1, 2006 Hedstrom sent the attorney for the seller of one unit letter stating that "At closing, title for the Unit shall be conveyed to . . . Hedstrom and. . . Kotter, as joint tenants, with right of survivorship." Ball v. Kotter, 723 F. 3d 813, 820 (7th Cir. 2013). Geldes spoke with Hedstrom shortly after sending this letter and explained to him the legal implications corresponding to the different manners in which the Units could be titled. Hedstrom told Geldes that he wanted to take care of Kotter and ensure that she get the unit after his death as he was leaving several other properties he owned to his children. The other unit was to be in the name of the Kotter Family Trust. Hedstrom died on January 20, 2007. The administrators of his trust, Susan L. Ball, and Ian K. Witteried, two of his children from his first marriage, were displeased with the result and filed a malpractice suit against both Geldes and Kotter. Summary judgment for Geldes was affirmed because there was no expert opinion suggesting that Geldes breached the standard of care. 723 F. 3d at 820. As to the breach of fiduciary duty claim against Kotter, the court also affirmed summary judgment. In a rather long opinion, the court ruled that:

> The evidence . . . establishes that Hedstrom had a full understanding of all relevant facts. The parties all agree that Hedstrom was a sophisticated business man and owned numerous other properties. . . .

723 F. 3d at 830. The court concluded that:

> As we have explained, the undisputed evidence demonstrates that Hedstrom received complete and adequate information regarding the Unit's titling and that he knew exactly what he was doing during the transactions, regardless of the future tax implications for his estate.

723 F. 3d at 833.

III. Accountants

DeLollis v. Friedberg, Smith & Co., P.C., 933 F. Supp. 2nd 354 (D. Conn. 2013 – applying New York law) dismissed a claim against Friedberg Smith & Co., Inc. (Friedberg) for "negligence, professional malpractice" arising out of Madoff-related investment vehicles. The case was brought by the trustees of three multi-employer employee benefit funds, the Empire State Carpenters Welfare Fund, Empire State Carpenters Annuity Fund, and Empire State Carpenters Pension Fund (collectively, the "Empire Funds") that invested assets in Beacon Associates LLC I and Beacon Associates LLC II ("Beacon") that in turn invested money in Madoff related investment vehicles. Friedberg performed annual audits of Beacon's financial statements and each year would issue its auditor's report of Beacon. These reports represented that Friedberg's:

> audit included an examination of evidence supporting the amounts and disclosures in the financial statements, assess the accounting principles used, and estimates made by management and evaluated the overall financial preparation.

973 F. Supp. 2d at 357. None of the audit reports disclosed any concern about the reported value of assets invested with Madoff or regarding the reported value of Empire Funds' capital accounts. Specifically, Friedberg's audits failed to give any indication that the assets invested in Madoff might be non-existent or that the reported value of those investments could be inaccurate or fictitious. The court rejected the theory that the auditor of an investment fund in which plaintiffs invested owed a duty directly to them to ensure that the entities in which the investment fund invested correctly and honestly reported the value of the investment funds investments:

> The notion that a firm engaged to audit financial statements of one client … must conduct audit procedures on a third party that is not an audit client … on whose financial statements that audit expresses no opinion is unprecedented and has no basis.

(numerous citations omitted). 938 F. Supp. 2d at 365. The complaint was dismissed for failure to state a claim for which relief could be granted.

In Bank of America, N.A. v. Knight, 725 F. 3rd 815 (7th Cir. 2013-applying Ill. law) claim was made that Bank of America lost about $34 million when Knight Industries, Knight Quartz Flooring, Knight-Celotex (collectively Knight) went bankrupt. Bank of America alleged that Knight's directors and managers looted the firm and that its accountant failed to detect the defalcations. Claims like this had been permitted under Illinois law pursuant to Brumley v. Touche, Ross & Co., 487 N.E. 2nd 641 (1985), which held that an accountant could be liable to a client's lenders if the accountant knew that the lenders might rely on the accountant's work. Subsequent to Brumley the Illinois legislature enacted 225 ILCS 450/30.1, which provides that an accountant is liable is only to its clients unless the accountant committed fraud (not alleged in this case) or "was aware that a primary intent of the client was for professional services to benefit or influence the particular person bringing the action." 725 F. 3d at 816. In upholding summary judgment for accounting firm the Court of Appeals noted that at oral argument counsel for the bank was asked why it sued the accountants rather than arranging for the bankruptcy trustee to make the claim. The response was that the bank did not want to share any money recovered with anyone else. The complaint was amended twice. At the third try there were 87 pages but "it was short on specifics though not on words." 725 F. 3d at 818. On appeal the bank argued that the district judge abused his discretion by dismissing the complaint with prejudice rather than allowing it to try again to amend the complaint: "But in court, as in baseball, three strikes and you're out." 725 F. 3rd at 818.

Dennis G. Buckley, in his capacity as bankruptcy trustee of DVI, Inc. (DVI) appealed from the grant of the summary judgment motion for *Deloitte & Touche USA LLP* and *Deloitte & Touche, LLP*'s (collectively "Deloitte") and to exclude the testimony of his expert witness, Michael J. Epstein. The court rejected Buckley's argument that because Epstein had purportedly resigned as Buckley's expert witness before *Deloitte's* motion to exclude his testimony was decided, the relief requested in that motion was moot and that granting it was an abuse of discretion: "Notwithstanding that Epstein had resigned, at least in theory he could have later agreed to testify at trial. *Deloitte* was therefore entitled to a ruling on whether Epstein's testimony was inadmissible." *Buckley vs. Deloitte & Touche USA LLP*, 541 Fed. Appx. 62, 63 (2nd Cir. 2013). As to the merits, the district court did not abuse its discretion in excluding Epstein's report as lacking a sufficient factual basis. Epstein had opined that had *Deloitte* reported that DVI's "loan loss reserve" was materially understated on any of the four alleged "breach dates", DVI's Board of Directors would have successfully restructured or liquidated DVI. Epstein further opined that, with respect to the first three of those dates, the Board would have adopted particular restructuring plans and DVI's lenders would have supported those plans. The Court of Appeals held the district court acted well within its discretion in excluding these opinions as "unduly speculative." Id. at 64. While Buckley argued that the district court set an impermissible hurdle that no plaintiff asserting claims of auditer liability ever can surpass the Court of Appeals observed that he overlooked "the fact that the district court identified several specific examples of types of evidence that Epstein could have incorporated into his report to lend factual support to his opinions." 541 Fed. Appx. At 64. In the absence of Epstein's opinion, there was insufficient evidence in the record to permit a reasonable juror to find that:

> (1) but for Deloitte's allegedly failing to disclose that DVI's loan loss reserve was materially understated on the alleged breach dates at issue, the Board wold have restructured or liquidated DVI; or (2) but for Deloitte allegedly failing to disclose that DVI's loan loss reserve was materially understated on the first of the breach dates, the Board would have adopted the particular structuring plans described by Epstein, and DVI's lenders would have supported those plans. A different conclusion was not warranted by the sporadic deposition testimony of former DVI Board members and management that Buckley relied on in his brief. As the district cout recognized, none of that testimony suggested that the Board would have restructured DVI in the manner described by Epstein or would have liquidated DVI in response to discovery that DVI's loan loss reserve was understated.

Id. Finally, there was no causal connection between the breach and the loss, requiring affirmance of summary judgment on the contract claim.

Larry and Patricia Sumrall hired Dale K. Barker, Jr. (Barker) to provide professional help with past due taxes and other amounts they owed the IRS. After finding out that they had to pay the IRS over $222,000 in taxes, penalties and interest, the Sumralls were sued by Barker for unpaid bills; they counterclaimed for breach of contract, negligence and breach of fiduciary duty. After a bench trial, the district court concluded the Barker's services had been deficient, that he was entitled to no fees beyond what he had already been paid and that the Sumralls were entitled to $70,296.91 because their experts testified that Barker had a duty to complete the matter promptly after 1996 and that but for Barker's misconduct the matter could have been settled for $151,704.36. On appeal, the court rejected Barker's argument that the district court should have dismissed some claims as untimely because pursuant to Fed. R. Civ. P. 15(c)(1)(B) the amended counterclaim "relates back" when the amendment, as here, asserts a claim that arose out of the conduct complained of in the original pleading. The court also rejected Barker's argument that because he sent periodic statements to the Sumralls, which they signed, he was entitled to money under "account stated" principles, under which parties to a contractual relationship may form a new and separate binding agreement about the correctness of the amount due. In fact, however, boilerplate signed the Sumralls merely "acknowledge [ ] and accept [ ] … the terms of … [the] Service Agreement. [s]" but said nothing about the amount due or its correctness. Dale K. Barker Co., P.C. vs. Valley Plaza, 541 Fed. Appx. 810, 814 (10th Cir. 2013-applying Utah law). There was no error in the exclusion of Barker's expert testimony because his proferred opinions were not timely disclosed. Finally, there was no abuse of discretion in prohibiting Barker from using certain documents at trial when he had failed to produce them in discovery, despite requests and orders, and had disgorged them just before the trial and well after the close of discovery. 541 Fed. Appx. at 816.

John T. McMahan and Northwestern Nasal and Sinus Associates (NNASA) sued Deutsche Bank AG (D.B.), Dorcha Bank Securities, Inc. (DSI) (collectively "Deutsche Bank"), Robert Goldstein

(Goldstein) and American Express Tax and Business Services (AMEX), seeking damages for civil conspiracy, fraud, negligent misrepresentation, violation of the Illinois Consumer Fraud and Deceptive Business Practices Act (ICFA), breach of fiduciary duty, assisting the breach of fiduciary duty, breach of contract, and professional malpractice, because of a well-known tax shelter scheme which was created, promoted and executed by a network of banks, accounting firms, and law firms. The purported tax benefits of the scheme were ultimately disallowed by the IRS, resulting in substantial fines and back tax payments for those who participated. A few of the parties most responsible for design and implementation of the scheme were criminally prosecuted and other individuals and entities involved made substantial settlement payments to the United States government in order to avoid prosecution. In the early 1990s McMahan and NNASA, a corporation owned by McMahan, retained Goldstein, a certified public accountant, to perform tax and accounting services. Goldstein annually advised McMahan to make certain investments for purposes of reducing his income tax liability. In 2001 Goldstein referred McMahan to the law firm Jenkins & Gilchrist to engage in a tax shelter strategy known as "Son of Bond and Options Sales Strategy" ("Son of BOSS"). Goldstein and a lawyer from Jenkins met with McMahan in 2001 and explained that Son of BOSS was a legitimate investment strategy that would either generate profits or capital losses that could be used to reduce his income tax liability. McMahan was told that Jenkins would prepare an independent legal opinion letter approving the Son of BOSS investment which would protect plaintiffs in the event of an IRS audit. McMahan was also told that Deutsche Bank would handle the underlying financial transactions which involved the sale of foreign currency options. Relying on those assurances, McMahan decided that he and NNASA would participate in Son of BOSS. Despite these representations the defendants knew that Son of BOSS was an illegitimate tax saving strategy designed solely to avoid tax liability and reap large fees from investors. The defendants motion to dismiss on statute of limitations grounds was denied because Khan v. Deutsch Bank AG, 978 N.E. 2nd 1020, 1044 (Ill. 2012) ruled that pursuant to the Illinois "discovery rule" the limitations period did not begin to run until the investors received notice of a deficiency from the IRS. (Plaintiffs received notice of deficiency on October 10, 2010, and had filed their complaint on March 26, 2012.) The fraudulent misrepresentation and ICFA claims were dismissed because of failure to comply with Fed. R. Civ. P. 9(b), which requires that fraud claims must be pleaded with particularity (no details were provided as to when a crucial meeting took place, where it was held, or who said what). Rule 9(b) did not apply, however, to the negligent misrepresentation claim. The breach of contract claim was dismissed because it duplicated the malpractice claim and was not based on any specific contractual provisions. Finally, the court ruled that the complaint stated a claim for breach of fiduciary duty and civil conspiracy. McMahan v. Deutsche Bank AG, 938 F. Supp. 2nd 795 (N.D. Ill. 2013).

PAST COMMITTEE NEWSLETTERS

Visit the Committee's newsletter archive online at www.iadclaw.org to read other articles published by the Committee. Prior articles include:

FEBRUARY 2014
Consumer Protection Laws: Liability and Coverage Implications for Licensed Professionals and Their Insurers
Matthew Marrone

JANUARY 2014
Recent Developments in Legal Malpractice
Richard L. Neumeier

OCTOBER 2013
Property Managers that Are Collecting Assessments Are Not Debt Collectors under the FDCPA
Debora Verdier

SEPTEMBER 2013
Are a Lawyer's Communications with the Firm's In-House Counsel Privileged? Massachusetts and Georgia Say Yes, Provided Certain Conditions Are Met
Erin K. Higgins

AUGUST 2013
SIRS and Deductibles – Evolving Policies and Their Impact on Carrier Duties
Michael Hamilton

JULY 2013
Oxford Health Plans, LLC v. Sutter – Supreme Court Upholds Arbitrator's Ruling That Arbitration Clause Authorizes Class Arbitration
Mary G. Pryor

JUNE 2013
Recent Professional Liability & Professional Liability Coverage Cases
Brad Jones

MAY 2013
Another in a Long Line of Cases Narrowly Construing the Economic Loss Rule: Arizona Court of Appeals Holds that the Economic Loss Rule Does Not Bar Statutory Remedies under the Consumer Fraud Act
Mary G. Pryor